

## Water Utilities

Price:	\$40.30
Fair Value Estimate:	\$70.00
52-Week Range:	\$30.40 - \$54.52
Market Cap (MM):	9,874
Shr.O/S-Diluted (mm):	245.0
Average Daily Volume:	1,377,749
Book Value:	\$17.58
Dividend:	\$0.94
Yield:	2.3%

FYE: Dec	2019A	2020E	2021E
EPS:	\$1.47A	\$1.58E	\$1.66E
Prior EPS:		\$1.56	\$1.65
P/E Ratio:	27.4x	25.5x	24.3x

### Quarterly EPS:

Q1	\$0.28A	\$0.60A	\$0.66E
Q2	\$0.37A	\$0.23E	\$0.23E
Q3	\$0.48A	\$0.25E	\$0.26E
Q4	\$0.34A	\$0.50E	\$0.51E

EPS: adjusted

### Quarterly Revenue (M):

Q1	\$201A	\$256A	\$773E
Q2	\$219A	\$325E	\$342E
Q3	\$244A	\$352E	\$360E
Q4	\$226A	\$571E	\$579E
Year:	\$890A	\$1,504E	\$2,053E



May 11, 2020

## Essential Utilities Inc.

(WTRG) - BUY

## Strong 1Q20 Results in a Transformational Quarter; Reiterate BUY Rating, \$70 Fair Value

### PORTFOLIO MANAGER BRIEF

WTRG's 1Q20 adjusted EPS results exceeded expectations, in what was probably the most transformational quarter in the Company's history. Q1 saw the final closing of the Peoples Gas transaction, and then a filing with the IRS for tax repair at Peoples Gas. Also completed was an application with Pennsylvania Public Utility Commission (PAPUC) for the DELCORA acquisition. In addition to that the Company changed its name and stock symbol, and then activated its emergency response plans to deal with COVID-19. From our viewpoint, the investment case for ownership of WTRG shares continues to strengthen; and given the current yield of 2.3% (highest in the water sector peer group), we reiterate our BUY rating and \$70 Fair Value on WTRG shares.

### ANALYST NOTES

1Q20 Results Above Forecasts. On the top line, revenues increased 27% YOY, driven by the addition of Peoples Gas and new rates/surcharges in the water segment. At the bottom line, WTRG chose to elect tax repair accounting methodology for most of the Peoples Gas operations, which generated a \$5.9MM tax benefit in the quarter. All-in adjusted EPS of \$0.60 was above our \$0.53 estimate and consensus of \$0.58.

Pennsylvania is Generating Significant Acquisition Activity. While the Company's been active across its geographic footprint in terms of acquisitions, the State of Pennsylvania has been particularly meaningful when it comes to acquiring assets recently. In Q1 the Peoples Gas transaction was completed, and next up is the Delaware County Regional Water Quality Control Authority (DELCORA) which serves 42 municipalities and 500,000 people. Beyond DELCORA, the Company has two more signed agreements in Pennsylvania (New Garden and East Norriton) which will add another 7,000+ customers.

Other substantial targets that have been discussed publicly as potential asset sales in the State include the cities of Pittsburgh, Harrisburg and the Chester Water Authority. All-in the Company has signed purchase agreements expected to add the equivalent of 205,058 water & wastewater customers, with all but 512 of them in the Keystone State. Essential also noted that Virginia recently passed fair market value legislation, which is now in place in all 8 states where Essential operates. We certainly expect competition for assets where opportunities exist, but WTRG should continue to get its fair share of acquisitions within its service territories.

COVID-19 Actions Mirror Industry-Wide Best Practices. WTRG's response to COVID-19 is mirroring utility industry best practices, including following Federal and local guidelines in the areas of health & safety. Those employees that can work remotely are doing so, and social distancing work practices are in place. The Company suspended customer shut-offs early after COVID-19 risks were identified, and is not entering customer homes for non-essential work. In terms of the balance sheet, WTRG increased liquidity via a \$500MM 364 term loan in March.

Regulatory Update. YTD, the Company has completed rate case or surcharge filings for water operations in Illinois, North Carolina, Ohio and Virginia totaling \$5.2MM in additional revenues. In the Natural Gas segment, surcharge filings have been completed in Kentucky and Pennsylvania totaling \$977K. New base rates are expected shortly in Indiana, New Jersey, North Carolina and Ohio (total requests = \$10.1MM).

Summary/Valuation. Successful completion of the Peoples Gas transaction, election of tax repair accounting methodology, additional expected benefits from catch-up tax repair deductions for past investments, the upcoming closing of the DELCORA transaction, a full pipeline of acquisition opportunities across all operating states, continued rate relief.....the list of expected positive impacts on WTRG's financials is quite extraordinary at this moment in time.

In terms of valuation, recall our view on the sector in general that as long as earnings growth continues under the regulated investment model, P/E's may fluctuate with general market conditions but over time dividend increases will continue to push share prices higher as long as 1) interest rates remain static or move lower and 2) yields on utilities compare favorably with other types of investments. We've noted some of our peers are bringing P/E multiple assumptions for utility shares lower and in some cases doing a "sum-of-the-parts" methodology, whereby each reporting segment gets its own multiple. We abandoned that methodology years ago because we found ourselves perpetually missing equity tops when yield (and dividend increases) became the primary focus for utility investors.

Returning to WTRG shares, we note the Company's primary service territory of Pennsylvania remains the most constructive in the U.S. (in our opinion) for both natural gas and water utilities. When we last revisited valuation in our industry piece back on October 7th, the U.S. 10-Year T-Note was at 1.53%. WTRG shares were trading at a P/E of 27x 2021 EPS estimates, for a yield of 2.06%. The Peoples Gas transaction had not closed (and actually dragged on a bit longer than expected), which introduced some minor element of regulatory risk. Fast forward to Friday: the U.S. 10-Year T-Note closed at 0.69%, WTRG shares are trading at a P/E of 24x 2021 EPS estimates, for a yield of 2.33%. The Peoples Gas transaction has now closed, tax repair accounting (and its bottom line benefits) are in place, and regulatory risk present in October is not a factor.

All-in, we believe P/E multiples will once again begin moving higher for all the water utilities, but especially for WTRG shares, given 1) the yield of 2.33%, versus the group average yield of 1.88%, 2) due to our expectations that interest rates will remain low, and 3) that the earnings bias is decidedly upward. The shares hit a 52-week high of \$54.52 back on February 18th, and its a stronger Company with better earnings visibility today than it was just 3 months ago. Our view is that the need for yield has intensified, and will remain strong for the foreseeable future. We maintain our BUY rating and \$70 Fair Value, based on a P/E of 42x our 2021 EPS estimate of \$1.66.

## IMPORTANT DISCLOSURES

### Research Analyst Certification

I, Michael Gaugler, the Primarily Responsible Analyst for this research report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject securities or issuers. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views I expressed in this research report.

### Janney Montgomery Scott LLC ("Janney") Equity Research Disclosure Legend

Essential Utilities Inc. currently is, or during the past 12 months was, a Janney Montgomery Scott LLC client. Janney Montgomery Scott LLC, provided investment banking related services.

Janney Montgomery Scott LLC currently acts as a market-maker in the securities of Essential Utilities Inc..

Janney Montgomery Scott LLC managed or co-managed a public offering of securities for Essential Utilities Inc. in the past 12 months.

Janney Montgomery Scott LLC received compensation for investment banking services from Essential Utilities Inc. in the past 12 months.

Janney Montgomery Scott LLC intends to seek or expects to receive compensation for investment banking services from Essential Utilities Inc. in the next three months.

The research analyst is compensated based on, in part, Janney Montgomery Scott's profitability, which includes its investment banking revenues.

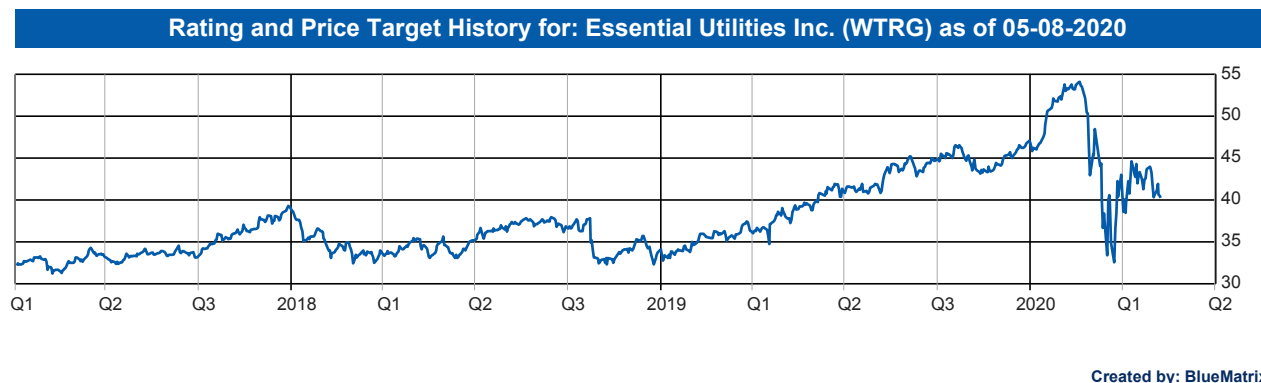
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**BUY:** Janney expects that the subject company will appreciate in value. Additionally, we expect that the subject company will outperform comparable companies within its sector.

**NEUTRAL:** Janney believes that the subject company is fairly valued and will perform in line with comparable companies within its sector. Investors may add to current positions on short-term weakness and sell on strength as the valuations or fundamentals become more or less attractive.

**SELL:** Janney expects that the subject company will likely decline in value and will underperform comparable companies within its sector.

### Price Charts



### Janney Montgomery Scott Ratings Distribution as of 03/31/2020

Rating	Count	Percent	IB Serv./Past 12 Mos.*	
			Count	Percent
<b>BUY [B]</b>	169	51.84	35	20.71
<b>NEUTRAL [N]</b>	156	47.85	22	14.10
<b>SELL [S]</b>	1	0.31	0	0.00

\*Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.

## Other Disclosures

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